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AFFORDABLE HOUSING AND COMMUNITY DEVELOPMENT ADVISORY

New York City's Article XI Real Property Tax Exemption Program: Providing Attractive Real Property Tax Benefits for Multi-family Properties

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KEY POINTS

- The Housing Preservation Opportunities Program (the Program) offers attractive real property tax exemptions for multi-family projects located in New York City, including those that may be experiencing economic difficulty or that have existing real property tax benefits soon expiring (such as existing 421(a) or J51 tax benefits).
- The Program offers a 40-year real property tax exemption that sets real property taxes on residential portions of multifamily properties at a percentage of gross potential residential and commercial income.
- The amount of benefits available to a project is bifurcated by New York City Housing Preservation and Development (HPD) into two broad affordability groups, each having different levels of real property tax benefits. The Program requires that all residential units be subject to rent stabilization for the term of the Program, whether through currently rent stabilized units or registering units that are not currently rent stabilized, as a condition to inclusion in the Program).

Introduction

The Program, which offers multi-family properties with a partial real property tax exemption under Article XI of the New York State Private Housing Finance Law (Article XI), is an attractive benefit for New York City multi-family properties, particularly those that are either experiencing financial challenges and legal restraints on de-regulation resulting from the Housing Stability and Tenant Protection Act of 2019, COVID-19 or otherwise, or which have other real property tax benefits expiring soon (such as existing 421(a) or J51 tax benefits). The Program generally provides Article XI real property tax exemptions over a 40-year term for multi-family housing in an effort to achieve HPD's stated goal to "ensure the long-term affordability and operating viability of quality housing." The benefits afforded under Article XI have been utilized to preserve continued affordability of existing multi-family housing, as well as expand affordability to include unregulated properties.

In order to provide clarity to owner's considering the Program, HPD recently issued a Term Sheet outlining the requirements, terms and benefits of the Program. This Term Sheet provides greater clarity and guidance to owners evaluating the Program. While we have summarized the principal terms of the Term Sheet, it is important to recognize that HPD is afforded broad discretion to determine the final terms of the real property tax benefits awarded to a particular project under the Program. Therefore, an owner seeking to avail itself of the real property tax benefits afforded under the Program will find itself in a negotiation with HPD over the extent of these benefits and the scope of the various affordability restrictions that will be imposed upon the project — attorneys at Katten are adept at assisting in such negotiations with HPD and are available to guide owners in navigating the Article XI process.

Eligible Owners/Properties

The Program requires that the property be owned by a Housing Development Fund Company or Corporation (HDFC) formed with the consent of HPD. Current owners of existing projects are eligible, provided they enter into a nominee agreement with an HPD-approved, existing HDFC or a new HDFC. Beneficial ownership may be retained by for-profit or non-profit entities pursuant to a nominee agreement approved by HDFC (such beneficial owners, together with the HDFC, referred to as "Owner"). Eligible properties consist of rent stabilized, rent, or income restricted or unregulated multi-family rental properties that are in good physical condition or where physical improvements can be made without use of HPD subsidy.

HPD's administration of the Program also affords HPD discretion to prioritize projects for inclusion in the Program based upon specific characteristics outlined in the Term Sheet, as well as attributes that HPD determines serve "other meaningful housing policy benefits." The specific characteristics outlined in the Term Sheet include whether (1) a significant portion of the units are restricted at or below 50% and 30% of Area Median Income (AMI), (2) a significant portion of vacant units are set aside for formerly homeless households (known as a "homeless set aside"), (3) housing conditions will be improved by the completion of outstanding immediate rehabilitation or repairs that require a tax exemption to facilitate financing, (4) the property currently experiences operational issues, as evidenced by an inability to meet standard debt service coverage ratios or income-to-expense ratios, and (4) a significant portion of the units will have rents reduced for existing tenants as a result of inclusion in the Program.

Article XI Tax Exemption Benefits

The Program provides Article XI benefits in the form of a 40-year partial exemption of residential assessed value of the project through a gross rent tax (GRT) that is calculated as a percentage of the gross potential residential and commercial income for the project. Essentially, the real property taxes payable with respect to the residential portion of the project is set at the percentage of GRT determined by HPD (unless the real property taxes are otherwise less than the GRT adjusted exemption). The sizing of this exemption is determined by HPD using one of the following two methods:

<u>Method 1 – Projects Currently Rent Stabilized</u>:

- Projects where average current rents are below 60% of Area Median Income (AMI) and for which a significant majority of the units are rent stabilized, and where there is no, or a limited, difference between preferential and legal rents, will have their benefits sized by HPD under Method 1.
- Method 1 projects may be considered by HPD for inclusion in the Program to receive an exemption with a GRT set at 5% (note that projects with average current rents above 60% AMI may receive an exemption with a GRT set at 15%).
  - The GRT could be adjusted upward by HPD if the net present value of the exemption exceeds $50,000 per unit.
  - The GRT could be adjusted downward by HPD in order to (1) satisfy a minimum income-to-expense ratio of 1.05 and a debt service coverage ratio of 1.25 for senior debt, (2) finance immediate physical needs, or (3) achieve additional policy goals as directed by HPD, such as funding transition reserves for substantial immediate homeless placements.

Method 2 – Projects With Portions Not Rent Stabilized or at Risk of Losing Rent Stabilization Protections:

- Projects where there are no current rent restrictions or for which there is potential for rent increases or loss of rent stabilization (e.g. projects with rent stabilization protections scheduled to expire in connection with expiring 421(a) or J51 tax benefits), projects with a portion of units that are not rent stabilized, or projects with a gap between existing preferential and legal rents will have their benefits sized by HPD under Method 2.
- Method 2 projects may be considered by HPD for inclusion in the Program to receive an exemption (1) having a GRT set at 10% for years one to five, and (2) having a GRT during years six to 40 that will be calculated based upon a cost benefit analysis that compares the value of the regulations to the cost of the exemption. The Term Sheet outlines the assumptions to be employed in performing such cost benefit analysis.
  - The GRT for years one to five could be adjusted downward by HPD in order to satisfy a minimum income-to-expense ratio of 1.05 and a debt service coverage ratio of 1.25 for senior debt.
  - If the supportable GRT for years six to 40 exceeds 10%, then the higher GRT will apply for all 40 years.

Regulatory Restrictions

The Program requires that projects enter into a regulatory agreement having a term of 40 years that is co-terminus with the length of the tax benefits afforded under the Program. Such regulatory agreement is recorded against the project. In addition to the affordability restrictions outlined above, at least two-thirds of the units must be rent and income restricted below 165% AMI. Such regulatory agreement will restrict all residential units and must contain the following restrictions (in addition to the other restrictions outlined herein):

- Rent Stabilization: All residential units must be rent stabilized (including registering those units that are not currently rent stabilized) and such restrictions will extend beyond the term of the exemption.
- Rent Restrictions:
  - The rents for all units must be restricted into one or more regulatory tiers averaging at least 10% of AMI below current market rent for the neighborhood and where the restricted average rents are no more than 10% higher than current rents.
  - Method 2 projects must either (1) restrict rents for at least 30% of units at or below 60% of AMI, with at least 15% of all units restricted at rents that are below 30% AMI and below 50% AMI, or (2) agree to a 20% minimum homeless set aside.
- Income Restrictions:
  - Units with rents restricted at or below 80% of AMI may be rented to households earning up to 10% of AMI above the regulated rent restriction (unless otherwise restricted).
  - Units with rents restricted above 80% of AMI may be rented to households earning up to 20% of AMI above the regulated rent restriction (unless otherwise restricted).
- Homeless Set Aside: Unless a Method 2 project is adopting the 20% homeless set aside option outlined above, all projects must include a minimum of a 10% homeless set aside, which must be satisfied using current vacancies and/or units that first become vacant after closing.
- Debt, Encumbrances and Conveyances: HPD approval is required for all transfers of the project (including transfers of any beneficial interest) and any debt or other lien encumbrance of the project.

Closing Requirements

The closing requirements for projects admitted to the Program are outlined in the Term Sheet and include: (1) the review and approval of the Article XI benefits through a resolution by the New York City Council, which shall include a letter of support from the City Council Member(s) in whose district the project is located, (2) completion of an Integrated Physical Needs Assessment from an approved firm and completion of immediate and short term physical needs, (3) compliance with the City's Aging in Place initiative, (4) being subject to Prevailing Wage requirements if located within a City-initiated zoning area, (5) notification to all tenants of the project's inclusion in the Program and the regulatory restrictions and exemption terms, and (6) submission of owner disclosure statements and documents for HPD sponsor review and approval.

CONTACTS

For more information or to discuss how your property may benefit from the Program, please contact Katten's Affordable Housing and Community Development practice or the following attorneys:

Martin Siroka
+1.212.940.6679
martin.siroka@katten.com

Scott Vetri
+1.212.940.6397
scott.vetri@katten.com